

REPORT OF THE AUDITOR-GENERAL TO WESTERN CAPE PROVINCIAL PARLIAMENT AND THE COUNCIL ON KNYSNA MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Knysna Municipality set out on pages 9 to 83, which comprise the statement of financial position as at 30 June 2012, the statement of financial performance, the statement of changes in net assets and the cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2011 (Act No. 6 of 2011) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Knysna Municipality as at 30 June 2012, and its financial performance and cash flows for the year then ended in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

7. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Significant uncertainties

8. As disclosed in note 53 to the financial statements, the municipality is the defendant in an action instituted for damages and claims against the municipality for R2 030 750 plus interest of 15,5% per annum from 6 March 2004, bringing the total claim to R6 314 504. The ultimate outcome of the matter cannot presently be determined and no provision for any liability that may result has been made in the financial statements.

Restatement of corresponding figures

9. As disclosed in note 38 to the financial statements, the corresponding figures for 30 June 2011 have been restated as a result of errors discovered during the 2011-12 financial year in the financial statements of the Knysna Municipality at, and for the year ended, 30 June 2011.

Material losses/impairments

10. As disclosed in note 44.4 to the financial statements, the municipality incurred material technical and non-technical water distribution losses during the year equalling 14,4% of purified water and amounting to R7 362 215 (2010-11: 18,2%).
11. As disclosed in note 15 and 31 to the financial statements the municipality incurred material impairment losses of R90 472 000 and R128 574 813 on investment property and property, plant and equipment, respectively.
12. As disclosed in note 20 to the financial statements the municipality had receivables from exchange transactions totalling R82 919 418 at 30 June 2012 (2010-11: R70 733 632). A provision for impairments of R46 219 799 has been made against the debtors balance for doubtful debts (2010-11: R27 671 336).
13. As disclosed in note 21 to the financial statements the municipality had receivables from non-exchange transactions totalling R39 664 974 at 30 June 2012 (2010-11: R28 782 980). A provision for impairments of R13 599 409 has been made against the debtors balance for doubtful debts (2010-11: R8 912 908).
14. As disclosed in note 43.3 to the financial statements, the municipality has materially underspent on the capital budget to the amount of R25 102 155 of which R15,4 million has been approved for rollover to the 2012-13 budget.

Additional matter

15. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited supplementary schedules

16. The supplementary information set out on pages 84 to 85 does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

17. In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

18. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages 22 to 33 of the annual report.
19. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury *Framework for managing programme performance information (FMPPi)*.

The reliability of the information in respect of the selected objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

20. The material findings are as follows:

Usefulness of information

21. Improvement measures in the annual performance report for all the planned targets not achieved were not disclosed as required by section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA). This was due to inadequate internal policies and procedures over the processes pertaining to the reporting of performance information.
22. For 50% of the indicators, the reported prior year actual performance included as comparative information in the 2011-12 annual performance report did not agree to the actual performance reported in the published 2010-11 annual report.
23. The National Treasury *FMPPi* requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 34% of the targets were not specific in clearly identifying the nature and the required level of performance. This was due to the municipality not adequately reviewing the integrated development plan (IDP) to ensure that all key performance indicators that were set were specific.
24. The National Treasury *FMPPi* requires that indicators/measures should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 47% of the indicators/measures were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the municipality not adequately reviewing the IDP to ensure that all key performance indicators that were set were specific.

Reliability of information

25. The National Treasury *FMPP* requires that processes and systems which produce the indicator should be verifiable. A total of 65% of the actual reported performance relevant to the selected objectives either differed materially when compared to the source information and/or evidence provided or could not be substantiated by sufficient appropriate evidence. This was due to Municipality not having adequate controls and processes in place to enable to valid, accurate and complete measurement and reporting of performance information.

Additional matter

26. I draw attention to the following matter below. This matter does not have an impact on the predetermined objectives audit findings reported above.

Achievement of planned targets

27. Of the total number of planned targets, only 21 were achieved during the year under review. This represents 21% of total planned targets that were not achieved during the year under review. Furthermore, 26 of the total number of targets set for the year are in respect of objectives that are considered to be qualitatively material in relation to the municipality's key service delivery objectives. Of these targets, 42% were not achieved during the year under review. This was as a result of the municipality not considering relevant systems and evidential requirements during the annual strategic planning process.

Compliance with laws and regulations

28. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the *General Notice* issued in terms of the PAA are as follows:

Strategic planning and performance management

29. The accounting officer did not monitor and annually review, as part of the municipal entity's annual budget process as set out in section 87 of the MFMA, the performance of the municipal entity against the agreed performance objectives and indicators as required by section 93B(b) of MSA.

Annual financial statements, performance and annual report

30. The annual performance report for the year under review did not include measures taken to improve performance, as required by section 46(1)(c) of the MSA.
31. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the Municipal Finance Management Act. Material misstatements of non-current assets, liabilities and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.

Procurement and contract management

32. Awards were made to providers who are persons in service of other state institutions or whose directors/principal shareholders are persons in service of other state institutions, in contravention of SCM regulations 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).

33. Persons in service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e).

Expenditure management

34. The accounting officer did not promptly inform the mayor and the MEC for local government in the province, in writing, of any unauthorised, irregular or fruitless and wasteful expenditure incurred by the municipality; whether any person is responsible or under investigation for such unauthorised, irregular or fruitless and wasteful expenditure; and the steps that had been taken to recover or rectify such expenditure and to prevent a recurrence of such expenditure, as required by section 32(4) of the MFMA.

Internal control

35. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

36. Leadership did not implement adequate measures to exercise sufficient oversight responsibility regarding financial and performance reporting and compliance. This resulted in material findings on the financial statements and annual performance report not being prevented or detected and instances of material non-compliance with laws and regulations not being identified and corrected in a timely manner.

Financial and performance management

37. Processes relating to the collection and collation of information supporting the quarterly and annual performance report have not been adequately institutionalised at line department level to ensure that information is collected on a regular basis to support the annual performance report. Consequently the annual performance report contained material misstatements that were identified during the audit process, as well as instances where sufficient appropriate evidence could not be presented to substantiate actual performance. This was mainly due to staff members not fully understanding the performance information requirements
38. The financial statements contained material errors that were identified during the audit process. This was mainly due to the municipality not implementing adequate controls to ensure that information used to support the amounts in the financial statements was valid, accurate and complete and that the financial statement amounts and disclosures were accurate.

39. The municipality has also not implemented adequate procedures to monitor compliance on a regular basis and to address instances of non-compliance identified, in a timely manner.

Auditor-General

Cape Town

30 November 2012



AUDITOR - GENERAL
SOUTH AFRICA

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